

Under Armour, Inc.  
Form 10-Q  
May 08, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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(Mark One)

**x** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2007

or

**..** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-51626

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**UNDER ARMOUR, INC.**

(Exact name of registrant as specified in its charter)

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Maryland  
(State or other jurisdiction of

incorporation or organization)

1020 Hull Street

52-1990078  
(I.R.S. Employer

Identification No.)

(410) 454-6428

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**Baltimore, Maryland 21230**  
(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Class A Common Stock, \$.0003 1/3 par value, 34,919,245 shares outstanding as of April 30, 2007 and Class B Convertible Common Stock, \$.0003 1/3 par value, 13,250,000 shares outstanding as of April 30, 2007.

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**UNDER ARMOUR, INC.**

**MARCH 31, 2007**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Under Armour, Inc. and Subsidiaries****Consolidated Balance Sheets****(in thousands, except share data)**

|                                                                                                                                                                                                                                                        | <b>March 31,<br/>2007<br/>(unaudited)</b> | <b>December 31,<br/>2006</b> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------|
| <b>Assets</b>                                                                                                                                                                                                                                          |                                           |                              |
| Current assets                                                                                                                                                                                                                                         |                                           |                              |
| Cash and cash equivalents                                                                                                                                                                                                                              | \$ 57,202                                 | \$ 70,655                    |
| Accounts receivable, net of allowance for doubtful accounts of \$809 and \$884 as of March 31, 2007 and December 31, 2006, respectively                                                                                                                | 84,553                                    | 71,867                       |
| Inventories                                                                                                                                                                                                                                            | 80,068                                    | 81,031                       |
| Income taxes receivable                                                                                                                                                                                                                                | -                                         | 4,310                        |
| Prepaid expenses and other current assets                                                                                                                                                                                                              | 7,849                                     | 8,944                        |
| Deferred income taxes                                                                                                                                                                                                                                  | 9,197                                     | 8,145                        |
| Total current assets                                                                                                                                                                                                                                   | 238,869                                   | 244,952                      |
| Property and equipment, net                                                                                                                                                                                                                            | 35,423                                    | 29,923                       |
| Intangible asset, net                                                                                                                                                                                                                                  | 7,500                                     | 7,875                        |
| Deferred income taxes                                                                                                                                                                                                                                  | 6,023                                     | 5,180                        |
| Other non-current assets                                                                                                                                                                                                                               | 1,503                                     | 1,438                        |
| Total assets                                                                                                                                                                                                                                           | \$ 289,318                                | \$ 289,368                   |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                                                                                                            |                                           |                              |
| Current liabilities                                                                                                                                                                                                                                    |                                           |                              |
| Accounts payable                                                                                                                                                                                                                                       | \$ 35,964                                 | \$ 42,718                    |
| Accrued expenses                                                                                                                                                                                                                                       | 15,889                                    | 25,403                       |
| Income taxes payable                                                                                                                                                                                                                                   | 1,966                                     | -                            |
| Current maturities of long term debt                                                                                                                                                                                                                   | 2,847                                     | 2,648                        |
| Current maturities of capital lease obligations                                                                                                                                                                                                        | 622                                       | 794                          |
| Total current liabilities                                                                                                                                                                                                                              | 57,288                                    | 71,563                       |
| Long term debt, net of current maturities                                                                                                                                                                                                              | 2,158                                     | 1,893                        |
| Capital lease obligations, net of current maturities                                                                                                                                                                                                   | 803                                       | 922                          |
| Other long term liabilities                                                                                                                                                                                                                            | 2,446                                     | 602                          |
| Total liabilities                                                                                                                                                                                                                                      | 62,695                                    | 74,980                       |
| Commitments and contingencies (see Note 5)                                                                                                                                                                                                             |                                           |                              |
| Stockholders' equity and comprehensive loss                                                                                                                                                                                                            |                                           |                              |
| Class A Common Stock, \$.0003 1/3 par value; 100,000,000 shares authorized as of March 31, 2007 and December 31, 2006, 34,886,385 shares issued and outstanding as of March 31, 2007; 34,555,907 shares issued and outstanding as of December 31, 2006 | 12                                        | 12                           |
| Class B Convertible Common Stock, \$.0003 1/3 par value; 16,200,000 shares authorized as of March 31, 2007 and December 31, 2006, 13,250,000 shares issued and outstanding as of March 31, 2007 and December 31, 2006                                  | 4                                         | 4                            |

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|                                            |            |            |
|--------------------------------------------|------------|------------|
| Additional paid-in capital                 | 151,847    | 148,562    |
| Retained earnings                          | 75,165     | 66,376     |
| Unearned compensation                      | (363)      | (463)      |
| Accumulated other comprehensive loss       | (42)       | (103)      |
| Total stockholders' equity                 | 226,623    | 214,388    |
| Total liabilities and stockholders' equity | \$ 289,318 | \$ 289,368 |

See accompanying notes.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Consolidated Statements of Income****(in thousands, except per share amounts)**

|                                                   | <b>Three Months Ended<br/>March 31,</b> |                    |
|---------------------------------------------------|-----------------------------------------|--------------------|
|                                                   | <b>2007</b>                             | <b>2006</b>        |
|                                                   | <b>(unaudited)</b>                      | <b>(unaudited)</b> |
| Net revenues                                      | \$ 124,329                              | \$ 87,696          |
| Cost of goods sold                                | 63,748                                  | 43,384             |
| Gross profit                                      | 60,581                                  | 44,312             |
| Operating expenses                                |                                         |                    |
| Selling, general and administrative expenses      | 44,544                                  | 30,132             |
| Income from operations                            | 16,037                                  | 14,180             |
| Other income, net                                 | 694                                     | 498                |
| Income before income taxes                        | 16,731                                  | 14,678             |
| Provision for income taxes                        | 6,790                                   | 5,944              |
| Net income                                        | \$ 9,941                                | \$ 8,734           |
| <b>Net income available per common share</b>      |                                         |                    |
| Basic                                             | \$ 0.21                                 | \$ 0.19            |
| Diluted                                           | \$ 0.20                                 | \$ 0.18            |
| <b>Weighted average common shares outstanding</b> |                                         |                    |
| Basic                                             | 47,619                                  | 46,486             |
| Diluted                                           | 49,818                                  | 49,499             |

See accompanying notes.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(in thousands)**

|                                                                               | <b>Three Months Ended<br/>March 31,</b> |                    |
|-------------------------------------------------------------------------------|-----------------------------------------|--------------------|
|                                                                               | <b>2007</b>                             | <b>2006</b>        |
|                                                                               | <b>(unaudited)</b>                      | <b>(unaudited)</b> |
| <b>Cash flows from operating activities</b>                                   |                                         |                    |
| Net income                                                                    | \$ 9,941                                | \$ 8,734           |
| Adjustments to reconcile net income to net cash used in operating activities  |                                         |                    |
| Depreciation and amortization                                                 | 2,972                                   | 1,838              |
| Unrealized foreign exchange rate gain                                         | (105)                                   | -                  |
| Stock-based compensation                                                      | 742                                     | 244                |
| Deferred income taxes                                                         | (1,474)                                 | 59                 |
| Changes in reserves for doubtful accounts, returns, discounts and inventories | 578                                     | 181                |
| Changes in operating assets and liabilities:                                  |                                         |                    |
| Accounts receivable                                                           | (13,101)                                | (7,455)            |
| Inventories                                                                   | 981                                     | 132                |
| Prepaid expenses and other current assets                                     | 1,104                                   | 86                 |
| Other non-current assets                                                      | (108)                                   | (5)                |
| Accounts payable                                                              | (6,770)                                 | (6,941)            |
| Accrued expenses and other liabilities                                        | (9,283)                                 | (2,707)            |
| Income taxes payable and receivable                                           | 6,276                                   | 4,037              |
| Net cash used in operating activities                                         | (8,247)                                 | (1,797)            |
| <b>Cash flows from investing activities</b>                                   |                                         |                    |
| Purchase of property and equipment                                            | (8,042)                                 | (4,588)            |
| Purchases of short-term investments                                           | (22,425)                                | -                  |
| Proceeds from sales of short-term investments                                 | 22,425                                  | -                  |
| Net cash used in investing activities                                         | (8,042)                                 | (4,588)            |
| <b>Cash flows from financing activities</b>                                   |                                         |                    |
| Proceeds from long-term debt                                                  | 1,117                                   | 1,202              |
| Payments on long-term debt                                                    | (653)                                   | (584)              |
| Payments on capital lease obligations                                         | (291)                                   | (559)              |
| Excess tax benefits from stock-based compensation arrangements                | 1,792                                   | 950                |
| Proceeds from exercise of stock options and other stock issuances             | 853                                     | 681                |
| Net cash provided by financing activities                                     | 2,818                                   | 1,690              |
| Effect of exchange rate changes on cash and cash equivalents                  | 18                                      | 10                 |
| Net decrease in cash and cash equivalents                                     | (13,453)                                | (4,685)            |
| <b>Cash and cash equivalents</b>                                              |                                         |                    |
| Beginning of period                                                           | 70,655                                  | 62,977             |
| End of period                                                                 | \$ 57,202                               | \$ 58,292          |
| <b>Non-cash financing and investing activities</b>                            |                                         |                    |
|                                                                               | \$ -                                    | \$ 734             |

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Fair market value of shares withheld in consideration of employee tax obligations relative to stock-based compensation

|                                                                                                   |       |     |
|---------------------------------------------------------------------------------------------------|-------|-----|
| Reversal of unearned compensation and additional paid in capital due to the adoption of SFAS 123R | -     | 715 |
| Increase to long term liabilities due to the adoption of FIN 48                                   | 1,597 | -   |
| See accompanying notes.                                                                           |       |     |

**Table of Contents****Under Armour, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements****(unaudited)****(amounts in thousands, except per share amounts)****1. Description of the Business**

Under Armour, Inc. is a developer, marketer and distributor of branded performance apparel, footwear and accessories. Sales are targeted to athletes and teams at the collegiate and professional level as well as consumers with active lifestyles throughout the world.

**2. Summary of Significant Accounting Policies****Basis of Presentation**

The accompanying consolidated financial statements include the accounts of Under Armour, Inc. and its wholly owned subsidiaries (the Company). All inter-company balances and transactions have been eliminated. The accompanying consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America.

**Interim Financial Data**

The results for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007 or any other portions thereof. Certain information in footnote disclosures normally included in annual financial statements has been condensed or omitted for the interim periods presented, in accordance with the rules and regulation of the Securities and Exchange Commission (the SEC) for interim consolidated financial statements.

These financial statements do not contain all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments, consisting of normal, recurring adjustments considered necessary for a fair presentation of the financial position and results of operations have been included.

The consolidated balance sheet as of December 31, 2006 is derived from the audited financial statements included in the Company's Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2006 (the 2006 Form 10-K), which should be read in conjunction with these consolidated financial statements.

**Concentration of Credit Risk**

Financial instruments that subject the Company to significant concentration of credit risk consist primarily of accounts receivable. The majority of the Company's accounts receivable is due from large sporting goods retailers. Credit is extended based on an evaluation of the customer's financial condition and collateral is not required. The most significant customers that accounted for a large portion of net revenues and accounts receivable are as follows:

|                                   | <b>Customer<br/>A</b> | <b>Customer<br/>B</b> | <b>Customer<br/>C</b> |
|-----------------------------------|-----------------------|-----------------------|-----------------------|
| Net revenues                      |                       |                       |                       |
| Three months ended March 31, 2007 | 20.4%                 | 14.6%                 | 5.0%                  |
| Three months ended March 31, 2006 | 21.6%                 | 16.1%                 | 3.7%                  |
| Accounts receivable               |                       |                       |                       |
| As of March 31, 2007              | 23.3%                 | 17.2%                 | 5.3%                  |
| As of March 31, 2006              | 26.5%                 | 21.1%                 | 4.9%                  |



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**Under Armour, Inc. and Subsidiaries**

**Notes to the Consolidated Financial Statements (Continued)**

**(unaudited)**

**(amounts in thousands, except per share amounts)**

**Short-Term Investments**

The Company purchases and sells short-term investments consisting of auction rate municipal bonds. All of these short-term investments are classified as available-for-sale securities. These auction rate securities are recorded at cost, which approximates fair market value due to their variable interest rates, which typically reset at the regular auctions every 7 to 35 days. Despite the long-term nature of their stated contractual maturities, the Company has the ability to liquidate these securities primarily through the auction process. As a result, the Company had no unrealized gains or losses from its investments in these securities. All income generated from these short-term investments is tax exempt and recorded as interest income. These securities were sold prior to March 31, 2007. Proceeds were invested in highly liquid investments with an original maturity of three months or less. Other income, net on the consolidated statements of income included interest income of \$753 and \$704 for the three months ended March 31, 2007 and 2006, respectively, primarily related to short-term investments and cash and cash equivalents.

**Accounts Receivable**

Accounts receivable are recorded at the invoice price net of an allowance for doubtful accounts and reserves for returns and certain sales allowances, and do not bear interest. The majority of discounts earned by customers in the period are recorded as liabilities within accrued expenses as they stipulate settlements to be made through Company cash disbursements. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in accounts receivable. The Company reviews the allowance for doubtful accounts monthly. Receivable balances are written off against the allowance when management believes it is probable the receivable will not be recovered. The Company does not have any off-balance-sheet credit exposure related to its customers.

**Inventories**

Inventories consist of finished goods, raw materials and work-in-process, and are valued at standard cost which approximates the Company's landed cost, using the first-in, first-out (FIFO) method of cost determination. Costs of finished goods inventories include all costs incurred to bring inventory to its current condition, including freight-in, duties and other costs. The Company does not include certain costs incurred to operate its distribution center in cost of goods sold. Historically, such costs would not have had a material impact on inventories, cost of goods sold, or gross profit.

The Company periodically reviews its inventories and makes provisions as necessary for estimated obsolescence or damaged goods to ensure values approximate lower of cost or market. The amount of such markdowns is equal to the difference between cost of inventory and the estimated market value based upon assumptions about future demands, selling prices, and market conditions.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****(unaudited)****(amounts in thousands, except per share amounts)**

Inventories consist of the following:

|                      | <b>March 31,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|----------------------|---------------------------|------------------------------|
| Finished goods       | \$ 82,791                 | \$ 83,618                    |
| Raw materials        | 1,319                     | 1,321                        |
| Work-in-process      | 73                        | 133                          |
| Subtotal inventories | 84,183                    | 85,072                       |
| Inventories reserve  | (4,115)                   | (4,041)                      |
| Total inventories    | \$ 80,068                 | \$ 81,031                    |

**Intangible Assets**

Intangible assets that are determined to have a definite life are amortized over the asset's estimated useful life. The Company continually evaluates whether events or circumstances have occurred that indicate the remaining estimated useful life of intangible assets may warrant revision or that the remaining balance may not be recoverable. When factors indicate that an intangible asset should be evaluated for possible impairment, the Company reviews the intangible asset to assess recoverability from future operations using undiscounted cash flows. Impairments are recognized in earnings to the extent that the carrying value exceeds fair value. No impairments relating to intangible assets were recognized for the three months ended March 31, 2007 and 2006.

**Income Taxes**

The Company recorded \$6,790 and \$5,944 of income tax expense for the three months ended March 31, 2007 and 2006, respectively. The effective rate for income taxes was 40.6% and 40.5% for the three months ended March 31, 2007 and 2006, respectively. The Company's annual 2007 effective tax rate is expected to be higher than the 2006 annual effective tax rate of 34.0% primarily due to the state tax credits recorded during 2006, which were not earned or recorded during 2007.

**Currency Translation**

The functional currency for the Company's wholly owned foreign subsidiaries is the applicable local currency. The translation of the foreign currency into U.S. dollars is performed for assets and liabilities using current exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period. Capital accounts are translated at historical exchange rates. Unrealized translation gains and losses are included in stockholders' equity as a component of accumulated other comprehensive income or loss. Beginning in 2007, adjustments that arise from exchange rate changes on transactions denominated in a currency other than the local currency are included in other income, net.

**Revenue Recognition**

The Company recognizes revenue pursuant to applicable accounting standards, including the SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*, which summarizes certain of the SEC staff's views in applying generally accepted accounting principles to revenue recognition in financial statements and provides guidance on revenue recognition issues in the absence of authoritative literature addressing a specific

arrangement or a specific industry.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****(unaudited)****(amounts in thousands, except per share amounts)**

Net revenues consist of both net sales and license revenues. Net sales are recognized upon transfer of ownership, including passage of title to the customer and transfer of risk of loss related to those goods. Transfer of title and risk of loss is based upon shipment under free on board ( FOB ) shipping-point for most goods. In some instances, transfer of title and risk of loss takes place at the point of sale (e.g. at the Company's retail outlet stores). Net sales are recorded net of reserves for returns and certain sales allowances. Provisions for customer-based incentives such as cooperative advertising, included in selling, general and administrative expenses, are based on contractual obligations with certain major customers. Returns are estimated at the time of sale based primarily on historical experience and recent trends. License revenues are recognized based upon shipment of licensed products sold by our licensees. Sales taxes imposed on our revenues from product sales are presented on a net basis and are excluded from net revenues.

**Earnings per Share**

Basic earnings per common share is computed by dividing net income available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income available to common stockholders for the period by the diluted weighted average common shares outstanding during the period. Diluted earnings per share reflects the potential dilution from common shares issuable through stock options, restricted stock and other equity awards. The following represents a reconciliation from basic earnings per share to diluted earnings per share:

|                                                                       | <b>Three Months Ended<br/>March 31,</b> |             |
|-----------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                       | <b>2007</b>                             | <b>2006</b> |
| <b>Numerator</b>                                                      |                                         |             |
| Net income, as reported                                               | \$ 9,941                                | \$ 8,734    |
| <b>Denominator</b>                                                    |                                         |             |
| Weighted average common shares outstanding                            | 47,619                                  | 46,486      |
| Effect of dilutive securities                                         | 2,199                                   | 3,013       |
| Weighted average common shares and<br>dilutive securities outstanding | 49,818                                  | 49,499      |
| Earnings per share - basic                                            | \$ 0.21                                 | \$ 0.19     |
| Earnings per share - diluted                                          | \$ 0.20                                 | \$ 0.18     |

Effects of potentially dilutive securities are presented only in periods in which they are dilutive. Options to purchase 130 and 81 shares of common stock were outstanding for the three months ended March 31, 2007 and 2006, respectively, but were excluded in the computation of diluted earnings per share because their effect would be anti-dilutive.

**Stock-Based Compensation**

Prior to January 1, 2006, the Company accounted for grants of stock rights to employees and directors using the intrinsic value method prescribed in Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees* ( ABP 25 ), and related interpretations. Under the intrinsic value method, unearned compensation was recorded equal to the fair market value of the stock underlying the award on the date of grant less any exercise price. Compensation expense was amortized over the vesting period in accordance with Financial Interpretation Number ( FIN ) 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* ( FIN 28 ).



**Table of Contents****Under Armour, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****(unaudited)****(amounts in thousands, except per share amounts)**

Effective January 1, 2006, the Company adopted the provisions of the Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 123R, *Share-Based Payment (revised 2004)* ( SFAS 123R ). SFAS 123R supersedes APB 25 and requires that all stock rights granted to employees and directors be measured at the fair value of the award and recognized as an expense in the financial statements.

Compensation expense includes the expense of stock rights granted subsequent to January 1, 2006 and the expense for the remaining vesting term of stock rights granted subsequent to the Company's initial filing of the S-1 Registration Statement with the SEC on August 26, 2005. Stock rights granted to employees and directors prior to the Company's initial filing of the S-1 Registration Statement are specifically excluded from SFAS 123R and will continue to be accounted for in accordance with APB 25 and FIN 28 until unearned compensation of \$363 as of March 31, 2007 is fully amortized through 2010. For the three months ended March 31, 2007 and 2006, the Company recognized \$100 and \$94, respectively, in amortization of unearned compensation in accordance with APB 25 and FIN 28.

Had the Company elected to account for all stock rights granted to employees and directors at fair value in accordance with SFAS 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* ( SFAS 148 ), net income and earnings per share for the three months ended March 31, 2007 and 2006 would have been reported as set forth in the following table:

|                                                                                                                 | <b>Three Months Ended<br/>March 31,</b> |             |
|-----------------------------------------------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                                                                 | <b>2007</b>                             | <b>2006</b> |
| Net income, as reported                                                                                         | \$ 9,941                                | \$ 8,734    |
| Add: stock-based compensation expense included in reported net income, net of taxes                             | 441                                     | 144         |
| Deduct: stock-based compensation expense determined under fair value based methods for all awards, net of taxes | (474)                                   | (177)       |
| Pro forma net income                                                                                            | \$ 9,908                                | \$ 8,701    |
| Earnings per share including SFAS 123 compensation expense                                                      |                                         |             |
| Basic, pro forma                                                                                                | \$ 0.21                                 | \$ 0.19     |
| Diluted, pro forma                                                                                              | \$ 0.20                                 | \$ 0.18     |
| Basic, as reported                                                                                              | \$ 0.21                                 | \$ 0.19     |
| Diluted, as reported                                                                                            | \$ 0.20                                 | \$ 0.18     |

**Management Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates, including estimates relating to assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Recently Issued Accounting Standards**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115*, ( SFAS 159 ). SFAS 159 permits



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**Under Armour, Inc. and Subsidiaries**

**Notes to the Consolidated Financial Statements (Continued)**

**(unaudited)**

**(amounts in thousands, except per share amounts)**

entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, ( SFAS 157 ) which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial statements.

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ( FIN 48 ), which provides additional guidance and clarifies the accounting for uncertainty in income tax positions. FIN 48 defines the threshold for recognizing tax return positions in the financial statements as more likely than not that the position is sustainable, based on its technical merits. FIN 48 also provides guidance on the measurement, classification and disclosure of tax return positions in the financial statements. FIN 48 is effective for the first reporting period beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to the beginning balance of retained earnings in the period of adoption. Upon adoption of FIN 48 as of January 1, 2007, the Company recorded a \$1,152 decrease to the beginning balance of retained earnings (see Note 6).

**Reclassifications**

Certain balances in 2006 have been reclassified to conform to the current period presentation. These changes had no impact on previously reported results of operations or stockholders' equity.

**3. Intangible Asset, Net**

In August 2006, the Company and NFL Properties LLC ( NFL Properties ) entered into a Promotional Rights Agreement (the NFL Agreement ) in which the Company became an authorized supplier of footwear to the National Football League. As partial consideration for the NFL Agreement, which expires in March 2012, the Company issued to NFL Properties fully vested and non-forfeitable warrants to purchase 480 shares of the Company's Class A Common Stock. The resulting \$8,500 intangible asset was determined based on the fair value of the warrants as established by an independent third party valuation. The intangible asset is amortized using the straight-line method over the term of the NFL Agreement.

As of March 31, 2007, the carrying amount of the intangible asset was \$7,500, which comprises the original fair value, net of \$1,000 in accumulated amortization. Amortization expense, which is included in selling, general and administrative expenses, was \$375 for the three months ended March 31, 2007. The estimated amortization expense of the intangible asset is \$1,500 for each of the years ended December 31, 2007 through December 31, 2011.

**4. Revolving Credit Facility and Long Term Debt**

In December 2006, the Company entered into an amended and restated financing agreement with a lending institution. This financing agreement has a term of five years and provides for a revolving credit line of up to \$100,000 based on the Company's domestic inventory and accounts receivable balances and may be used for

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**Under Armour, Inc. and Subsidiaries**

**Notes to the Consolidated Financial Statements (Continued)**

**(unaudited)**

**(amounts in thousands, except per share amounts)**

working capital and general corporate purposes. This financing agreement is collateralized by substantially all of the Company's domestic assets, other than its trademarks. Up to \$10,000 of the facility may be used to support letters of credit. The Company incurred \$260 in deferred financing costs in connection with the financing agreement. In accordance with EITF Issue No. 98-14, *Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements*, unamortized deferred financing costs of \$618 relating to the Company's old revolving credit facility were added to the deferred financing costs of the new revolving credit facility and are being amortized over the remaining life of the new facility.

If net availability under the financing agreement falls below a certain threshold as defined in the agreement, the Company would be required to maintain a certain leverage ratio and fixed charge coverage ratio as defined in the agreement. This financing agreement also provides the lenders with the ability to reduce the available revolving credit line amount under certain conditions even if the Company is in compliance with all conditions of the agreement. The Company's net availability as of March 31, 2007 was above the threshold for compliance with the financial covenants and the Company was in compliance with all applicable covenants as of March 31, 2007.

Prior to amending and restating the revolving credit facility in December 2006, the Company was a party to a \$75,000 revolving credit facility that was to terminate in 2010. Under this financing agreement, the Company was required to maintain prescribed levels of tangible net worth as defined in the agreement and was collateralized by substantially all of the assets of the Company.

During the three months ended March 31, 2007 and 2006, no balance was outstanding under the Company's revolving credit facility.

In March 2005, the Company entered into a loan and security agreement to finance the acquisition of up to \$17,000 of qualifying capital investments. This agreement is collateralized by a first lien on these assets and is otherwise subordinate to the revolving credit facility. Through March 31, 2007, the Company has financed \$9,032 of furniture and fixtures under this agreement. The weighted average interest rate on outstanding borrowings was 6.5% for the three months ended March 31, 2007. At March 31, 2007, the outstanding principal balance was \$5,005.

In December 2003, the Company entered into a master loan and security agreement that was subordinate to the revolving credit facilities. Under this agreement the Company borrowed \$1,250 for the purchase of qualifying furniture and fixtures. The interest rate was 7.0% annually, and principal and interest payments were due monthly through February 2006. The outstanding principal balance was repaid during February 2006.

**5. Commitments and Contingencies**

The Company is, from time to time, involved in routine legal matters incidental to its business. Management believes that the ultimate resolution of any such current proceedings will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Certain key executives are party to agreements with the Company that include severance benefits upon involuntary termination, including following a change in control of the Company.

In addition, within the normal course of business, the Company enters into contractual commitments, such as professional and collegiate sponsorship agreements and official supplier agreements, in order to promote the

**Table of Contents****Under Armour, Inc. and Subsidiaries****Notes to the Consolidated Financial Statements (Continued)****(unaudited)****(amounts in thousands, except per share amounts)**

Company's brand and products. These agreements include scheduled sponsorship fee payments or rights fee payments, along with other purchase or product supply obligations over the terms of the agreements.

**6. Provision for Income Taxes**

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recorded an additional \$1,597 liability for unrecognized tax benefits, of which \$1,152 was accounted for as a reduction to the January 1, 2007 balance of retained earnings with the remainder recorded within deferred tax assets. After recognizing these impacts upon adoption of FIN 48, the total unrecognized tax benefits were approximately \$2,054. Of this amount, approximately \$1,609 would impact our effective tax rate if recognized. The Company does not expect that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next twelve months.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in the provision for income taxes on the consolidated statements of income. The unrecognized tax benefits liability includes \$512 for the accrual of interest and penalties.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The majority of the Company's returns are no longer subject to U.S. federal, state and local or foreign income tax examinations by tax authorities for years before 2003.

**7. Segment Data and Related Information**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company operates exclusively in the consumer products industry in which the Company develops, markets, and distributes apparel, footwear and accessories. Based on the nature of the financial information that is received by the chief operating decision maker, the Company operates within two operating segments, North America and International, but only one reportable segment. Although the Company operates within one reportable segment, it has several different product categories for which the net revenues attributable to each product category are as follows:

|                    | <b>Three Months Ended<br/>March 31,</b> |             |
|--------------------|-----------------------------------------|-------------|
|                    | <b>2007</b>                             | <b>2006</b> |
| Men's              | \$ 68,465                               | \$ 53,659   |
| Women's            | 24,690                                  | 20,985      |
| Youth              | 10,491                                  | 7,039       |
| Apparel            | 103,646                                 | 81,683      |
| Footwear           | 11,839                                  | -           |
| Accessories        | 5,274                                   | 3,647       |
| Total net sales    | 120,759                                 | 85,330      |
| License revenues   | 3,570                                   | 2,366       |
| Total net revenues | \$ 124,329                              | \$ 87,696   |



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**Under Armour, Inc. and Subsidiaries**

**Notes to the Consolidated Financial Statements (Continued)**

**(unaudited)**

**(amounts in thousands, except per share amounts)**

The table below summarizes product net revenues by geographic regions based on customer location:

|                         | <b>Three Months Ended<br/>March 31,</b> |             |
|-------------------------|-----------------------------------------|-------------|
|                         | <b>2007</b>                             | <b>2006</b> |
| United States           | \$ 114,425                              | \$ 82,504   |
| Canada                  | 4,777                                   | 3,672       |
| Subtotal                | 119,202                                 | 86,176      |
| Other foreign countries | 5,127                                   | 1,520       |
| Total net revenues      | \$ 124,329                              | \$ 87,696   |

During the three months ended March 31, 2007 and 2006, substantially all of the Company's long-lived assets were located in the United States.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-Looking Statements**

Some of the statements contained in this Form 10-Q and any documents incorporated herein by reference constitute forward-looking statements. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the development and introduction of new products, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as *may*, *will*, *should*, *expects*, *plans*, *anticipates*, *believes*, *intends*, *estimates*, *predicts*, *potential* or the negative of these terms or other comparable terminology.

The forward-looking statements contained in this Form 10-Q and any documents incorporated herein by reference reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance or achievements. Readers are cautioned not to place undue reliance on these forward-looking statements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described in our 2006 Form 10-K, under *Risk Factors*, *Qualitative and Quantitative Disclosures About Market Risk* and *Management's Discussion and Analysis of Financial Condition and Results of Operations*. These factors include without limitation:

our ability to manage our growth effectively;

our ability to maintain effective internal controls;

the availability, integration and effective operation of management information systems and other technology;

increased competition causing us to reduce the prices of our products or to increase significantly our marketing efforts in order to avoid losing market share;

changes in consumer preferences or the reduction in demand for performance apparel and other products;

our ability to accurately forecast consumer demand for our products;

reduced demand for sporting goods and apparel generally;

failure of our suppliers or manufacturers to produce or deliver our products in a timely or cost-effective manner;

our ability to accurately anticipate and respond to seasonal or quarterly fluctuations in our operating results;

our ability to effectively market and maintain a positive brand image;

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our ability to attract and maintain the services of our senior management and key employees; and

changes in general economic or market conditions, including as a result of political or military unrest or terrorist attacks.

The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date of this Form 10-Q. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

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### **Overview**

We are a leading developer, marketer and distributor of branded performance products for men, women and youth. Since our founding in 1995, we have grown and reinforced our brand name and image through sales to athletes and teams at the collegiate and professional level, as well as sales to consumers with active lifestyles. We believe that Under Armour is a widely recognized athletic brand known for its performance and authenticity and is uniquely positioned as a performance alternative to traditional fiber products and non-performance apparel and footwear.

We reported net revenues of \$124.3 million for the first quarter of 2007, which represented a 41.8% increase from the first quarter of 2006. We believe that our growth in net revenues has been driven by a growing interest in performance products and the strength of the Under Armour brand in the marketplace relative to our competitors, as evidenced by the increases in sales of our men's, women's and youth products and the introduction of footwear.

We plan to continue to increase our net revenues by building upon our relationships with existing customers and expanding our product offerings in new and existing retail stores. To date, a large majority of our products have been sold in North America. We believe that our products appeal to athletes and consumers with active lifestyles around the globe. As early as 1999, the Under Armour brand has been sold in the Japanese market place through a third-party. By March 31, 2007, our products were offered primarily in the United States, Canada and Japan, as well as in the United Kingdom, France and Germany, in over 12,000 retail stores, up from approximately 500 retail stores in 2000. In addition, we have signed strategic distribution agreements to sell our products in 15 countries. In June 2006, we launched our footwear products with the introduction of football cleats and slides. New product offerings in 2007 include baseball and softball cleats, which we began shipping in the fourth quarter of 2006. In addition, in 2007 we plan to expand our product offerings to include additional men's and women's performance products as well as expand further into off-field outdoor sports, including hunting, fishing, running, mountain sports, skiing and golf. As we have expanded into new product lines, sales of our existing product lines have continued to grow. We plan to increase net revenues internationally by adding product offerings through our Japanese licensee and by expanding our European distribution. In order to support this initiative, during the first quarter of 2006 we opened a European Headquarters in Amsterdam, Netherlands that houses our European sales, marketing and logistics functions.

During the first quarter of 2007, we reported license revenues of \$3.6 million which represented a 50.9% increase from the first quarter of 2006. We have entered into licensing agreements with established, high-quality manufacturers to produce and distribute Under Armour branded products to further reinforce our brand identity and increase our net revenues and gross profit. In exchange for the use of our trademarks, our licensees pay us license revenues based on their net sales of core products of socks, hats, bags, eyewear and other accessories. We seek to continue to grow our license revenues by working with our existing licensees to offer additional products and increase their distribution, and by selectively entering into new licensing agreements.

### **General**

Net revenues comprise both net sales and license revenues. Net sales comprise our five primary product categories, which are men's, women's and youth apparel, accessories and footwear (beginning in the second quarter of 2006).

Cost of goods sold consists primarily of product costs, inbound freight and duty costs, handling costs to make products floor-ready to customer specifications, and write downs for inventory obsolescence. In addition, cost of goods sold includes overhead costs associated with our quick turn, Special Make-Up Shop and costs relating to our Hong Kong and Guangzhou, China offices which help support manufacturing, quality assurance and sourcing efforts. No cost of goods sold is associated with license revenues. We do not include our distribution facility costs in the calculation of the cost of goods sold, but rather include these costs as a component of our selling, general and administrative expenses. As a result, our gross profit may not be

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comparable to that of other companies that include distribution facility costs in the calculation of their cost of goods sold. We believe, however, that our distribution facility costs have not been of a sufficient magnitude to materially affect our gross margin for purposes of comparison.

Our selling, general and administrative expenses consist of marketing costs, selling costs, payroll and related costs (excluding those specifically related to marketing and selling) and other corporate costs. Our marketing costs are an important driver of our growth and we strive to manage our marketing costs to be within 10-12% of net revenues on an annual basis. Marketing costs include payroll costs specific to marketing, commercials, print ads, league and player sponsorships, amortization of footwear promotional rights and depreciation expense specific to our in-store fixture program. Selling costs consist primarily of payroll costs specific to selling, commissions paid to third parties and beginning in 2007, the selling costs relating to our Direct to Consumer business (Global Direct website and catalog sales, and our retail outlet stores). Prior period amounts have been reclassified to conform to the current period presentation. Payroll costs consist primarily of payroll and related costs, excluding those specifically related to marketing and selling, and stock-based compensation expense. Other corporate costs consist primarily of distribution and corporate facility costs, product creation costs and other company-wide administrative expenses. In recent years, our selling, general and administrative expenses have increased to support our growth and new sales initiatives.

During 2006, we earned and recognized a new state income tax credit which reduced our annual effective tax rate to 34.0%. We expect our 2007 annual effective tax rate to approximate 40.8%.

**Results of Operations**

The following table sets forth key components of our results of operations for the periods indicated, both in dollars and as a percentage of net revenues.

| <i>(In thousands)</i>                        | <b>Three Months Ended</b> |             |
|----------------------------------------------|---------------------------|-------------|
|                                              | <b>March 31,</b>          |             |
|                                              | <b>2007</b>               | <b>2006</b> |
| Net revenues                                 | \$ 124,329                | \$ 87,696   |
| Cost of goods sold                           | 63,748                    | 43,384      |
| Gross profit                                 | 60,581                    | 44,312      |
| Selling, general and administrative expenses | 44,544                    | 30,132      |
| Income from operations                       | 16,037                    | 14,180      |
| Other income, net                            | 694                       | 498         |
| Income before income taxes                   | 16,731                    | 14,678      |
| Provision for income taxes                   | 6,790                     | 5,944       |
| Net income                                   | \$ 9,941                  | \$ 8,734    |

| <i>(As a percentage of net revenues)</i>     | <b>Three Months Ended</b> |             |
|----------------------------------------------|---------------------------|-------------|
|                                              | <b>March 31,</b>          |             |
|                                              | <b>2007</b>               | <b>2006</b> |
| Net revenues                                 | 100.0%                    | 100.0%      |
| Cost of goods sold                           | 51.3%                     | 49.5%       |
| Gross profit                                 | 48.7%                     | 50.5%       |
| Selling, general and administrative expenses | 35.8%                     | 34.3%       |
| Income from operations                       | 12.9%                     | 16.2%       |
| Other income, net                            | 0.6%                      | 0.5%        |

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|                            |       |       |
|----------------------------|-------|-------|
| Income before income taxes | 13.5% | 16.7% |
| Provision for income taxes | 5.5%  | 6.7%  |
| Net income                 | 8.0%  | 10.0% |

**Table of Contents****Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006**

*Net revenues* increased \$36.6 million, or 41.8%, to \$124.3 million for the three months ended March 31, 2007 from \$87.7 million for the same period in 2006. This increase was the result of increases in both our net sales and license revenues as noted in the product category table below.

| <i>(In thousands)</i> | 2007       | Three Months Ended March 31,<br>2006 | \$ Change | % Change |
|-----------------------|------------|--------------------------------------|-----------|----------|
| Men s                 | \$ 68,465  | \$ 53,659                            | \$ 14,806 | 27.6%    |
| Women s               | 24,690     | 20,985                               | 3,705     | 17.7%    |
| Youth                 | 10,491     | 7,039                                | 3,452     | 49.0%    |
| Apparel               | 103,646    | 81,683                               | 21,963    | 26.9%    |
| Footwear              | 11,839     | -                                    | 11,839    | -        |
| Accessories           | 5,274      | 3,647                                | 1,627     | 44.6%    |
| Total net sales       | 120,759    | 85,330                               | 35,429    | 41.5%    |
| License revenues      | 3,570      | 2,366                                | 1,204     | 50.9%    |
| Total net revenues    | \$ 124,329 | \$ 87,696                            | \$ 36,633 | 41.8%    |

*Net sales* increased \$35.5 million, or 41.5%, to \$120.8 million for the three months ended March 31, 2007 from \$85.3 million during the same period in 2006 as noted in the table above. The increase in net sales primarily reflects:

\$11.8 million of new footwear product sales, primarily baseball cleats, which were introduced in the fourth quarter of 2006;

continued unit volume growth of our existing apparel products, such as compression products, primarily sold to existing retail customers due to additional retail stores and expanded floor space;

a 7.7% increase in apparel average selling prices driven by our merchandising strategy; and

new products introduced subsequent to March 31, 2006 within all product categories, most significantly in our compression, training, baseball and golf categories.

*License revenues* increased \$1.2 million, or 50.9%, to \$3.6 million for the three months ended March 31, 2007 from \$2.4 million during the same period in 2006. This increase in license revenues was a result of increased sales by our licensees due to increased distribution, continued unit volume growth, new product offerings and new licensing agreements, which now include distribution of products to college bookstores and golf pro shops.

*Gross profit* increased \$16.3 million to \$60.6 million for the three months ended March 31, 2007 from \$44.3 million for the same period in 2006. Gross profit as a percentage of net revenues, or gross margin, decreased approximately 180 basis points to 48.7% for the three months ended March 31, 2007 from 50.5% during the same period in 2006. This decrease in gross margin percentage was primarily driven by the following:

lower gross margin attributable to the introduction of our footwear products in the second quarter of 2006, which have lower profit margins than our current apparel products, accounting for an approximate 175 basis point decrease;

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higher product costs as a result of temporary variations in vendor sourcing needed to meet customer demand, accounting for an approximate 75 basis point decrease; and

increased sales returns and allowances, along with inventory reserves, accounting for an approximate 70 basis point decrease; partially offset by

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lower customer incentives as a percentage of net revenues, primarily driven by changes to certain customer agreements which decreased discounts while increasing certain customer marketing expenditures recorded in selling, general and administrative expenses, accounting for an approximate 80 basis point increase; and

increased Direct to Consumer higher margin sales, accounting for an approximate 60 basis point increase.

*Selling, general and administrative expenses* increased \$14.4 million to \$44.5 million for the three months ended March 31, 2007 from \$30.1 million for the same period in 2006. As a percentage of net revenues, selling, general and administrative expenses increased to 35.8% for the three months ended March 31, 2007 from 34.3% for the same period in 2006. These changes were primarily attributable to the following:

Marketing costs increased \$6.3 million to \$13.8 million for the three months ended March 31, 2007 from \$7.5 million for the same period in 2006. These changes were primarily due to print advertising campaigns, footwear promotional rights for the National Football League (the NFL), increased cooperative marketing costs for certain customers, continued investment in our international growth initiatives and sponsorship of new teams on the collegiate level. As a percentage of net revenues, marketing costs increased to 11.1% for the three months ended March 31, 2007 from 8.6% for the same period in 2006 due primarily to the items noted above. For the full year 2007, we plan to invest approximately 12% of our net revenues in marketing to promote our brand. However, due to the timing of planned investments in marketing, we plan to exceed this estimated percentage for the second quarter of 2007.

Selling costs increased \$3.0 million to \$9.6 million for the three months ended March 31, 2007 from \$6.6 million for the same period in 2006. This increase was primarily driven by the continued development of our Direct to Consumer business, along with additional personnel in our domestic and international sales force. As a percentage of net revenues, selling costs increased slightly to 7.7% for the three months ended March 31, 2007 from 7.5% for the same period in 2006.

Payroll and related costs (excluding those specifically related to marketing and selling) increased \$3.4 million to \$11.8 million for the three months ended March 31, 2007 from \$8.4 million for the same period in 2006. The increase for the first quarter of 2007 was due primarily to the addition of corporate personnel to support the following growth initiatives: continued investment in our European business; additional retail outlet stores; and the design and sourcing of our expanding footwear lines. Payroll and related costs also increased due to the additional personnel for the expansion of our distribution facilities to support our growth. As a percentage of net revenues, payroll and related costs (excluding those specifically related to marketing and selling) remained unchanged at 9.5% for the three months ended March 31, 2007 and 2006.

Other corporate costs, excluding payroll and related costs, increased \$1.6 million to \$9.3 million for the three months ended March 31, 2007 from \$7.7 million for the same period in 2006. This increase was attributable primarily to additional distribution facility operating costs to support our growth; post-implementation consulting costs and depreciation expense related to our new ERP system; and increased corporate costs relating to continued development of our Global Direct and European businesses. These increases were partially offset by lower legal expenses incurred during the three months ended March 31, 2007 as compared to the same period in 2006. As a percentage of net revenues, other corporate costs decreased to 7.5% for the three months ended March 31, 2007 from 8.8% for the same period in 2006 as we were able to experience leverage from our growth in net revenues during the 2007 period along with lower legal expenses.

*Income from operations* increased \$1.8 million, or 13.1%, to \$16.0 million for the three months ended March 31, 2007 from \$14.2 million for the same period in 2006. Income from operations as a percentage of net revenues decreased to 12.9% for the three months ended March 31, 2007 from 16.2% for the same period in 2006. This decrease was a result of a decrease in gross margin percentage and an increase in selling, general and administrative expenses as a percentage of net revenues.

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*Other income, net* increased \$0.2 million to \$0.7 million for the three months ended March 31, 2007 from \$0.5 million for the same period in 2006. This increase was primarily due to interest earned on auction rate municipal bonds.

*Provision for income taxes* increased \$0.9 million to \$6.8 million for the three months ended March 31, 2007 from \$5.9 million for the same period in 2006. For the three months ended March 31, 2007, our effective tax rate was 40.6% compared to 40.5% for the same period in 2006. Our annual 2007 effective tax rate is expected to be higher than our 2006 annual effective tax rate of 34.0% primarily due to the state tax credits recorded during 2006, which were not earned or recorded in 2007.

*Net income* increased \$1.2 million to \$9.9 million for the three months ended March 31, 2007 from \$8.7 million for the same period in 2006, as a result of the factors described above.

**Seasonality**

Historically, we have recognized approximately 70-75% of our income from operations in the last two quarters of the year, driven by increased sales volume of our products during the fall selling season, reflecting our historical strength in fall sports, and the seasonality of our higher priced ColdGear® line. Approximately 61% and 62% of our net revenues were generated during the last two quarters of 2006 and 2005, respectively. The level of our working capital reflects the seasonality and growth in our business. We generally expect inventory, accounts payable and accrued expenses to be higher in the second and third quarters in preparation for the fall selling season.

**Financial Position, Capital Resources and Liquidity**

Our cash requirements have principally been for working capital and capital expenditures. Working capital is primarily funded from cash flows provided by operating activities. Prior to our initial public offering in November 2005, our working capital was also funded from available revolving credit facilities. Our working capital requirements reflect the seasonality and growth in our business as we recognize a significant increase in sales leading up to the fall retail season. Cash requirements for capital investments needed to grow our business have primarily been funded through subordinated debt and capital lease obligations. During 2007 we plan to fund a portion of our working capital (specifically inventory) and capital investments from cash on hand. Our capital investments have included expanding our in-store fixture program, improvements to and expansion of our distribution and corporate facilities to support our growth, leasehold improvements to our new retail outlet stores, the investment in a Company-wide ERP system, which became operational in April 2006, and more recently, our new warehouse management system implementation.

We believe that our cash and cash equivalents on hand, cash from operations and borrowings available to us under our senior and subordinated debt facilities will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next twelve months.

The following table presents the major components of net cash flows used in and provided by operating, investing and financing activities for the periods stated:

|                                                              | Three Months Ended |            |
|--------------------------------------------------------------|--------------------|------------|
|                                                              | 2007               | 2006       |
| <i>(in thousands)</i>                                        |                    |            |
| Net cash (used in) provided by:                              |                    |            |
| Operating activities                                         | \$ (8,247)         | \$ (1,797) |
| Investing activities                                         | (8,042)            | (4,588)    |
| Financing activities                                         | 2,818              | 1,690      |
| Effect of exchange rate changes on cash and cash equivalents | 18                 | 10         |
| Net decrease in cash and cash equivalents                    | \$ (13,453)        | \$ (4,685) |

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### *Operating Activities*

Operating activities consist primarily of net income adjusted for certain non-cash items, including depreciation, deferred income taxes, changes in reserves for doubtful accounts, returns, discounts and inventories and the effect of changes in operating assets and liabilities, principally accounts receivable, inventories, accounts payable and accrued expenses.

Cash used in operating activities increased \$6.4 million to \$8.2 million for the three months ended March 31, 2007 compared to \$1.8 million during the same period in 2006. The \$6.4 million additional net use of cash in operating activities was due to higher cash outflows from operating assets and liabilities of \$8.0 million, partially offset by an increase in non-cash items provided by operating activities of \$0.4 million and an increase in net income of \$1.2 million period-over-period. The increase in cash outflows related to changes in operating assets and liabilities period-over period was primarily due to the following:

higher customer discounts paid during the first quarter of 2007 as compared to the same period last year;

increased accounts receivable of \$5.6 million period-over-period primarily attributable to the 41.5% increase in net sales in the first quarter of 2007 as compared to the same period last year; partially offset by

higher income taxes payable in 2007 compared to 2006; and

increased cash collections on our royalty receivable in the first quarter of 2007 as compared to the same period last year.

Non-cash items increased as a result of higher depreciation and amortization period-over-period primarily due to the implementation of our new ERP system in the second quarter of 2006, retail outlet store leasehold improvements and other additional assets. The increase in non-cash items was partially offset by increased deferred income tax assets.

### *Investing Activities*

Cash used in investing activities, which primarily represents capital expenditures, increased \$3.4 million to \$8.0 million for the three months ended March 31, 2007 from \$4.6 million for the same period in 2006. This increase in cash used in investing activities primarily represents the costs to improve and to expand our distribution facility, along with continued investment in our warehouse management system implementation and investments in our Direct to Consumer business.

In April 2006, we began investing a portion of our available cash and cash equivalents in short-term investments, which consist of auction rate municipal bonds. These investments have stated maturities of 14 to 42 years and have variable interest rates, which typically reset at regular auctions every 7 to 35 days. Despite the long-term nature of their stated contractual maturities, we have the ability to liquidate these securities primarily through the auction process. The income generated from these short-term investments is tax exempt and recorded as interest income. All investments in these securities were sold prior to March 31, 2007. Proceeds were invested in highly liquid investments with an original maturity of three months or less.

We currently anticipate capital investments for all of 2007 to be in the range of \$34.0 to \$36.0 million, of which approximately \$12.0 million will be invested in our distribution facility to add equipment to improve our shipping velocity and expand our warehouse capacity in anticipation of future growth in our footwear business. In addition, we plan to invest approximately \$11.0 million in our in-store fixture program, including concept shops and \$6.5 million in our Direct to Consumer business, including our retail stores and Global Direct website and catalog businesses. The balance will be invested in information technology initiatives and for other general corporate improvements.

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### *Financing Activities*

Cash provided by financing activities increased \$1.1 million to \$2.8 million for the three months ended March 31, 2007 from \$1.7 million for the same period in 2006. This increase was primarily due to an increase of \$0.8 million in excess tax benefits from stock-based compensation arrangements received during the first quarter 2007 as compared to the same period in the prior year.

### *Revolving Credit Facility Agreement*

In December 2006, we entered into an amended and restated financing agreement with a lending institution. This financing agreement has a term of five years and provides for a revolving credit line of up to \$100.0 million based on our domestic inventory and accounts receivable balances and may be used for working capital and general corporate purposes. This financing agreement is collateralized by substantially all of our domestic assets, other than our trademarks. Up to \$10.0 million of the facility may be used to support letters of credit.

The revolving credit facility bears interest based on the daily balance outstanding at our choice of LIBOR plus an applicable margin (varying from 1.0% to 2.0%) or the JP Morgan Chase Bank prime rate plus an applicable margin (varying from 0.0% to 0.5%). The applicable margin is calculated quarterly and varies based on our pricing leverage ratio as defined in the agreement. The revolving credit facility also carries a line of credit fee equal to the available but unused borrowings which can vary from 0.1% to 0.5%. As of March 31, 2007, our availability was \$99.9 million based on our domestic inventory and accounts receivable balances.

This financing agreement contains a number of restrictions that limit our ability, among other things, to pledge our accounts receivable, inventory, trademarks and most of our other assets as security in our borrowings or transactions; pay dividends on stock; redeem or acquire any of our securities; sell certain assets; make certain investments; guaranty certain obligations of third parties; undergo a merger or consolidation; or engage in any activity materially different from those presently conducted by us.

If net availability under the financing agreement falls below certain thresholds as defined in the agreement, we would be required to maintain a certain leverage ratio and fixed charge coverage ratio as defined in the agreement. This financing agreement also provides the lenders with the ability to reduce the available revolving credit line amount under certain conditions even if we are in compliance with all conditions of the agreement. We were in compliance with these covenants as of March 31, 2007.

During the three months ended March 31, 2007 and 2006, no balance was outstanding under the Company's revolving credit facility.

### *Subordinated Debt and Lease Obligations*

In March 2005, we entered into a loan and security agreement with a lending institution to finance the acquisition of up to \$17.0 million of qualifying capital investments. This agreement is collateralized by a first lien on these assets and is otherwise subordinate to the revolving credit facility. Through March 31, 2007, we have financed \$9.0 million of capital investments under this agreement. Interest on outstanding borrowings accrues at an average rate of 6.5%. At March 31, 2007, the outstanding principal balance was \$5.0 million.

In December 2003, we entered into a master loan and security agreement with a lending institution which was subordinate to the revolving credit facility. Under this agreement, we borrowed \$1.3 million for the purchase of qualifying furniture and fixtures. This agreement bore interest at 7.0% annually, and principal and interest payments were due monthly through February 2006. The outstanding principal balance was repaid during February 2006.

We lease warehouse space, office facilities, space for our retail outlet stores and certain equipment under non-cancelable operating and capital leases.

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### **Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. To prepare these financial statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates also affect our reported revenues and expenses. Judgments must be made about the disclosure of contingent liabilities as well. Actual results could be significantly different from these estimates. We believe that the following discussion addresses the critical accounting policies that are necessary to understand and evaluate our reported financial results.

#### *Revenue Recognition*

Net revenues consist of both net sales and license revenues. Net sales are recognized upon transfer of ownership, including passage of title to the customer and transfer of risk of loss related to those goods. Transfer of title and risk of loss is based upon shipment under free on board ( FOB ) shipping-point for most goods. In some instances, transfer of title and risk of loss takes place at the point of sale (e.g., at our retail outlet stores). Net sales are recorded net of reserves for returns and certain sales allowances. Returns are estimated at the time of sale based primarily on historical experience and recent trends. License revenues are recognized based upon shipment of licensed products sold by our licensees.

#### *Sales Returns, Allowances and Discounts*

We record reductions to revenue for estimated customer returns and allowances. We base our estimates on historical rates of customer returns and allowances as well as the specific identification of outstanding returns and allowances that have not yet been received by us. The actual amount of customer returns and allowances, which is inherently uncertain, may differ from our estimates. If we determined that actual or expected returns or allowances were significantly greater or lower than the reserves we had established, we would record a reduction or increase, as appropriate, to net sales in the period in which we made such a determination. We record the majority of customer-based incentives, which include certain cooperative advertising credits as selling, general and administrative expenses.

#### *Reserve for Uncollectible Accounts Receivable*

We make ongoing estimates relating to the collectibility of our accounts receivable and maintain a reserve for estimated losses resulting from the inability of our customers to make required payments. In determining the amount of the reserve, we consider our historical level of credit losses and make judgments about the creditworthiness of significant customers based on ongoing credit evaluations. Because we cannot predict future changes in the financial stability of our customers, actual future losses from uncollectible accounts may differ from our estimates. If the financial condition of our customers were to deteriorate, resulting in their inability to make payments, a larger reserve might be required. In the event we determined that a smaller or larger reserve was appropriate, we would record a benefit or charge to selling, general and administrative expense in the period in which we made such a determination.

#### *Inventory Valuation and Reserves*

We value our inventory at standard cost which approximates our landed cost, using the first-in, first-out method of cost determination. Market value is estimated based upon assumptions made about future demand and retail market conditions. If we determine that the estimated market value of our inventory is less than the carrying value of such inventory, we provide a reserve for such difference as a charge to cost of goods sold to reflect the lower of cost or market. If actual market conditions are less favorable than those projected by us, further adjustments may be required that would increase our cost of goods sold in the period in which the adjustments were recorded.

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### *Long-Lived Assets*

The acquisition of long-lived assets, including furniture and fixtures, office equipment, plant equipment, leasehold improvements, computer hardware and software and in-store fixtures, is recorded at cost and this cost is depreciated over the asset's estimated useful life. We continually evaluate whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance may not be recoverable. These factors may include a significant deterioration of operating results, changes in business plans or changes in anticipated cash flows. When factors indicate that an asset should be evaluated for possible impairment, we review long-lived assets to assess recoverability from future operations using undiscounted cash flows. Impairments are recognized in earnings to the extent that the carrying value exceeds fair value.

### *Intangible Assets*

Intangible assets that are determined to have a definite life are amortized over the asset's estimated useful life and are evaluated and measured for impairment in accordance with our Long-Lived Assets critical accounting policy discussed above.

### *Income Tax Provision*

We estimate our effective tax rate for the full year and record a quarterly income tax provision in accordance with the expected effective annual tax rate. As the year progresses, we continually refine our estimate based upon actual events and earnings by jurisdiction during the year. This process may result in a change to our expected effective tax rate for the year. When this occurs, we adjust the income tax provision during the quarter in which the change in estimate occurs so that the year-to-date provision equals the expected effective annual tax rate.

### *Stock-Based Compensation*

Compensation expense is recognized in accordance with the Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment (revised 2004)* (SFAS 123R), which we adopted on January 1, 2006. Compensation expense includes the expense of stock rights granted on and subsequent to January 1, 2006, and the expense for the remaining vesting terms of stock rights issued subsequent to our initial filing of the S-1 Registration Statement with the SEC on August 26, 2005. Stock rights granted prior to our initial filing of the S-1 Registration Statement are specifically excluded from SFAS 123R and will continue to be accounted for in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and Financial Interpretation (FIN) No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*, until fully amortized through 2010.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of highly subjective assumptions, including the expected life of the stock-based payment awards and stock price volatility. We use the Black-Scholes option-pricing model to value compensation expense. The assumptions used in calculating the fair value of stock-based payment awards represent management's best estimates, but the estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future (see Note 2 to the Consolidated Financial Statements for a further discussion on stock-based compensation).

### **New Accounting Pronouncements**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*, (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an

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instrument-by-instrument basis. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 159 on our consolidated financial statements.

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements*, ( SFAS 157 ) which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 157 on our consolidated financial statements.

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* ( FIN 48 ), which provides additional guidance and clarifies the accounting for uncertainty in income tax positions. FIN 48 defines the threshold for recognizing tax return positions in the financial statements as more likely than not that the position is sustainable, based on its technical merits. FIN 48 also provides guidance on the measurement, classification and disclosure of tax return positions in the financial statements. FIN 48 is effective for the first reporting period beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to the beginning balance of retained earnings in the period of adoption. Upon adoption of FIN 48 as of January 1, 2007, we recorded a \$1.2 million decrease to the beginning balance of retained earnings (see Note 6 to the Consolidation Financial Statements for a further discussion on the adoption of FIN 48).

## **ITEM 4. CONTROLS AND PROCEDURES**

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act ). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in the Company's internal control over financial reporting during the most recent quarter that has materially affected, or that is reasonably likely to materially affect the Company's internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1A. RISK FACTORS**

The Risk Factors, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, have not materially changed.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

From February 5, 2007 through April 16, 2007, we issued 244,463 shares of Class A Common Stock upon the exercise of previously granted employee stock options to employees at a weighted average exercise price of \$2.14 per share, for an aggregate amount of consideration of \$522,267. The following issuances of Class A Common Stock were made on the date indicated at exercise prices totaling the aggregate amount of consideration set forth in the following table:

| Date              | Number<br>of Shares<br>Issued | Aggregate<br>Amount of<br>Exercise<br>Price |
|-------------------|-------------------------------|---------------------------------------------|
|                   |                               |                                             |
| February 5, 2007  | 4,000                         | \$ 18,720                                   |
| February 6, 2007  | 6,000                         | 12,660                                      |
| February 7, 2007  | 2,500                         | 26,925                                      |
| February 8, 2007  | 1,000                         | 2,650                                       |
| February 9, 2007  | 15,500                        | 32,975                                      |
| February 12, 2007 | 3,500                         | 9,005                                       |
| February 13, 2007 | 3,000                         | 6,330                                       |
| February 15, 2007 | 1,250                         | 13,463                                      |
| February 16, 2007 | 3,000                         | 6,330                                       |
| February 20, 2007 | 36,500                        | 77,015                                      |
| February 21, 2007 | 33,000                        | 35,630                                      |
| February 27, 2007 | 30,000                        | 63,300                                      |
| February 28, 2007 | 2,000                         | 333                                         |
| March 2, 2007     | 2,502                         | 1,664                                       |
| March 7, 2007     | 96,286                        | 203,973                                     |
| March 13, 2007    | 250                           | 663                                         |
| March 14, 2007    | 1,125                         | 2,981                                       |
| March 19, 2007    | 400                           | 844                                         |
| March 26, 2007    | 1,500                         | 3,975                                       |
| April 16, 2007    | 1,150                         | 2,831                                       |
| <b>TOTAL</b>      | <b>244,463</b>                | <b>\$ 522,267</b>                           |

The issuances of securities described above were made in reliance upon Section 4(2) under the Securities Act in that any issuance did not involve a public offering or under Rule 701 promulgated under the Securities Act, in that they were offered and sold either pursuant to written compensatory plans or pursuant to a written contract relating to compensation, as provided by Rule 701.

**ITEM 6. EXHIBITS**

Exhibit No.

## Edgar Filing: Under Armour, Inc. - Form 10-Q

- 31.1 Section 302 Chief Executive Officer Certification
- 31.2 Section 302 Chief Financial Officer Certification
- 32.1 Section 906 Chief Executive Officer Certification
- 32.2 Section 906 Chief Financial Officer Certification

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNDER ARMOUR, INC.

By: /s/ WAYNE A. MARINO

Wayne A. Marino

*Executive Vice President and Chief Financial  
Officer*

Dated: May 8, 2007